Answers

Cases are given in the answers for educational purposes. Unless specifically requested, candidates are not required to quote specific case names to obtain the marks. Only the general principles involved are required.

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1 Report to Mr Kam

To: Mr Kam
From: Tax advisor
Date: 1 December 2014
Subject: Hong Kong tax position of 'Kam Kee' for 2013/14 and the proposed expansion of the business

We refer to our earlier meeting to discuss the financial position of Kam Kee and the proposed expansion of the restaurant business. We provide our advice on the respective issues as follows.

(a) Low interest rate loans to employees

(i) Hong Kong tax implications for Kam Kee

In Hong Kong, any person carrying on a trade, profession or business in Hong Kong is chargeable to profits tax under s.14 in respect of the profits derived from such trade, profession or business arising in or derived from Hong Kong. In addition, certain types of receipts, if not otherwise taxable under s.14, are statutorily deemed as Hong Kong sourced trading receipts of a business carried on in Hong Kong and taxable under s.15. The interest income earned by Kam Kee is one of the deemed trading receipts [s.15(1)(g)], under which interest income received by a person other than a corporation (like Mr Kam in this case) in respect of the funds of the person's trade, profession or business (like Kam Kee in this case) is deemed to be assessable to Hong Kong profits tax, as long as the interest is derived from a Hong Kong source. In determining the source of the interest income, the current practice is to apply the 'provision of credit' test (as stated in Departmental Interpretation and Practice Notes (DIPN) No. 13) except in the case where a mortgage asset is involved, or the money lending transaction is by itself a trade or business. By the 'provision of credit' test, the loan interest is regarded as sourced in Hong Kong if the credit of the loan is first made available to the borrower in Hong Kong. In the case of Kam Kee, the loans made to staff are presumably sourced in Hong Kong on the basis that the loans are provided to staff to buy properties for residence in Hong Kong. Therefore, the loan interest from staff is taxable to Kam Kee. The facts that the borrower is the staff of the business and the interest rate is lower than the market rate are irrelevant in determining the assessability of the interest income to Kam Kee.

However, in the event that the borrowing employee defaults on their loan repayment and the business decides to write off the loan, the 'write-off' represents a loss which is not incurred in the production of assessable profits. This is because deduction for bad debts is allowable only where the debts have previously been included as taxable trading receipts (in Kam Kee's case, as sales) or the debts arise from amounts of money lent in the ordinary course of a money lending business [s.16(1)(d)(i)]. From the facts given, Kam Kee is very unlikely to be running a business of money lending by lending to its staff only, and the debts do not arise from sales. Therefore, the losses resulting from its employees' defaults in repaying the staff loans to Kam Kee will not be tax deductible to the business for profits tax purposes.

(ii) Hong Kong tax implications for the borrowing employees

From the perspective of the borrowing employees, the concerns lie with (a) whether the loan interest expense can be tax deductible against their assessable income from employment for salaries tax purposes, and (b) whether the benefit of a lower interest rate will be taxable to them.

As regards the loan interest expense deduction, if employees borrow and apply the loan money to finance a property used as their primary place of residence in Hong Kong, they can claim the home loan interest as a concessionary deduction against their assessable income from employment. The annual maximum deduction is $100,000 and each taxpayer is entitled to such a deduction for 15 years in total, whether continuous or not.

On the issue of whether the benefit of paying a lower interest rate would be taxable to the employees, the prevailing position of the Inland Revenue Department (IRD) based on DIPN No. 16 is that low interest loans provided by employers to employees are not chargeable benefits to the employees provided that the cost involved in providing the benefit is the sole liability of the employer. As a result, the low interest benefit would not be regarded as convertible into cash.

The salaries tax positions of the employees is not relevant to Kam Kee's profits tax position on the interest income.

(b) Hong Kong tax implications of specific profit and loss items

(i) Medical subsidy to staff (Note 4)

Under the profits tax regime, any expense or outgoing is tax deductible to the extent it is incurred in the production of assessable profits [s.16(1)]. It is not required for the expense to have a direct nexus to the assessable profits. That the expense is incurred in the ordinary course of carrying on a business from which assessable profits are derived, is sufficient for the deduction to be allowed, except for an expense of a capital nature. In the case of Kam Kee, costs spent on employees, including salaries and perquisites, will be deductible since the employees have been engaged in the business which derives taxable income. The medical subsidy paid for staff in the form of a cash reimbursement is regarded as perquisites for the employees, and will be allowed as a tax deduction by Kam Kee for profits tax purposes.

From the perspective of the employees, as medical expenses are regarded as private expenses which are not deductible to the employees, the reimbursement of this non-deductible expense would be taxable income to the employees under salaries tax. This tax treatment of the reimbursement by the employees for their salaries tax purposes will not affect the deductibility position of the item by Kam Kee under profits tax.

Mr Kam has the intention of joining an employees' group medical insurance scheme under which all the employees will be covered by the medical insurance policy. Qualifying medical expenses would be claimed against and reimbursed by the insurance company. However, Kam Kee would need to pay annual premiums to the insurance company for the scheme. There is a concern whether such an arrangement would result in a different tax position for Kam Kee. For the purpose of profits tax, insurance premiums paid for the employees' medical scheme would still be considered as costs spent on the employees for the production of assessable profits, and thus deductible under s.16(1). This tax position is no different from the current position where the medical subsidy is tax deductible, except that the amount may be different. However, the salaries tax positions of the employees would be different. The reimbursements obtained from the insurance company by the employees would not be taxable under salaries tax on the basis that the benefits are not convertible into cash and the employees are paid in the capacity of beneficiaries under the insurance policy. Despite this, the profits tax deductibility of the insurance premiums paid by Kam Kee would not be affected by the change in the employees' salaries tax positions.

(ii) Compensation to staff on leaving (Note 4)

The deductibility of the compensation payment made to a leaving employee in return for a promise not to join a competitor for a period of five years depends on whether the outgoing is capital in nature or not. If it is capital in nature, the outgoing is not deductible under s.17(1(c). Based on case law, in general, the tests to identify capital expenditure include: the 'fixed v circulating capital' test, 'once-and-for-all' test, and 'enduring benefit' test. While expenditure connected with fixed capital (such as fixed assets) is normally considered to be of a capital nature, expenditure incurred on circulating capital (such as inventory) is generally regarded as revenue in nature. From another perspective, an expenditure which recurs year by year would generally carry a revenue nature (such as office rent), and an expenditure which is incurred only once and for all would normally be considered as a capital expense (such as an incorporation fee). The enduring benefit test is taken from the perspective of the nature of benefit created by the expenditure. If the expenditure gives rise to a benefit which is enduring in nature and lasting longer than normal revenue expenditure, it is likely that the expenditure is capital in nature. In the case of Kam Kee, the compensation payment is made for the purpose of securing a covenant from the leaving employee not to compete for a time-span of five years after the employee leaves; given the length of this time span, the benefit is likely to be considered as long lasting and enduring. The payment is therefore capital expenditure and not deductible for profits tax purposes.

(iii) Interest expense on bank mortgage loan for staff quarters (Note 8)

A mortgage loan was obtained from a bank to finance the acquisition of a residential property used as staff quarters. Under the IRO, interest expense deductibility is governed by s.16(1), s.16(1)(a) and s.16(2), subject to the restrictions under s.16(2A) and s.16(2B). Section 16(1) requires that any expense or outgoing, such as an interest expense, is deductible to the extent that the expense is incurred in the production of assessable profits. Specific to an interest expense, s.16(1)(a) provides that interest on money borrowed 'for the purpose of producing assessable profit', together with other related expenditure, is deductible provided that any condition under s.16(2) is satisfied. Ascertaining whether interest is incurred 'for the purpose of producing assessable profits' is usually dependent upon how the loan proceeds are applied, and in the case where the proceeds are used to acquire an asset, whether or not the asset is used to 'produce assessable profits'. The fact that the loan money was applied to acquire a captial asset does not render the loan interest to be a capital expense unless the capital asset so acquired is not immediately used for producing assessable profits. In the case of Kam Kee, the mortgage loan is obtained to acquire residential property which has been occupied by the staff for accommodation purposes. The provision of accommodation to staff is considered as a kind of employee benefit which, together with other staff costs, contributes to the operation of the business for the production of assessable profits. As a result, the interest of $190,000 on the mortgage loan satisfies both s.16(1) and s.16(2)(a). As regards the condition under s.16(2), the payment of interest to a bank already satisfies s.16(2)(d). Since the bank loan was mortgaged over the property acquired and presumably there is no arrangement whereby the interest expense would flow back to Kam Kee as non-taxable interest income, neither the restrictions under s.16(2A) nor s.16(2B) will apply. In conclusion, the bank mortgage loan interest will be tax deductible under profits tax.

(c) Computation of Kam Kee's profits tax liability for the year of assessment 2013/14

	$	$
Profit before tax		300,000
Add: Depreciation charge	300,000	
Compensation to leaving staff	50,000	
Staff loan written off	150,000	
Legal and professional fee on tax appeal	70,000	
Tax penalty	80,000	
Refurbishment (to be claimed over the next four years)	400,000	1,050,000
		1,350,000
Less: Depreciation allowance (working)	(450,000)	
Interest income from sole proprietor	(20,000)	(470,000)
		880,000
Less: Tax loss brought forward		(200,000)
Net assessable profits		680,000

Working – Depreciation allowance:

	Plant and machinery – 20% pool	Plant and machinery – 30% pool	Commercial buildings allowance (CBA)	Total depreciation allowance
	$	$	$	$
WDV brought forward	100,000	100,000	–	
Annual allowance	20,000	30,000	–	50,000
WDV carried forward	80,000	70,000	–	
Qualifying cost	–	–	10,000,000	
CBA at 4%			400,000	400,000
Total				450,000

(d) Hong Kong tax implications of acquiring another restaurant

Mr Kam is interested in acquiring the business of another restaurant. The proposed acquisition is to be by way of an asset transfer, whereby the trading stock and furniture and fixtures are to be transferred. An additional payment will be made for the goodwill. From the perspective of Mr Kam, the new restaurant will be run under the same business as 'Kam Kee' and thus the assets to be acquired will be merged and aggregated into Kam Kee's accounts.

In the case of trading stock, the tax treatment generally follows the accounting treatment so that the price paid for the trading stock will be recorded in the accounts, and taken as the cost of goods sold and be tax deductible against future revenue. Therefore, if the allocation of a higher sale value to the trading stock could be justified, it would be more advantageous to do so, because a higher cost of goods sold would give a lower level of taxable income upon future sale. However, it is important that any price allocation should be reasonable and benchmarked to market value.

In the case of furniture and fixtures, it is unclear whether the price represents the net book value of the assets, or their tax written down values. When they are acquired by Kam Kee, the price represents the capital expenditure to be used for calculating the tax depreciation allowance. The higher the sale value allocated to depreciable assets, the greater the tax depreciation allowance which could be claimed by Kam Kee. Therefore, subject to the same justification by reference to market value, it is worth considering allocating a higher value of consideration to the furniture and fixtures.

Payment for goodwill will not give rise to any tax implications to Kam Kee since goodwill is a capital asset and thus any expenditure would either not be recorded in the statement of profit or loss or not eligible for a tax deduction.

We trust that the above addresses all the significant Hong Kong profits tax implications for the issues raised. Should there be any questions, please let us know.

End of Report

2 Amy

(a) Accommodation arrangement

(i) The accommodation benefit is a benefit statutorily specified as taxable under salaries tax in Hong Kong, as long as it represents a reward for services from employment. The taxable benefit is extended to cover the accommodation provided by either the employer or an associated corporation. Therefore, in the case of Amy, it would be irrelevant whether H Ltd or M Ltd would ultimately be her employer. The accommodation provided by H Ltd would remain assessable under salaries tax.

(ii) If Amy chooses to live in the staff quarters, this would be regarded as a place of residence provided rent-free by her employer (or an associated corporation) [under s.9(1)(c)], and taxable under salaries tax. The taxable value will be calculated by way of 'rental value', which is equivalent to 10% of Amy's assessable income from the employer (or an associated corporation) (excluding any share option gain, retirement sum or terminal payment) after deducting the allowable expenses and depreciation allowance. The rateable value of the property (according to the Rating Ordinance), if lower, could be used instead. For the purpose of calculating the rental value for salaries tax purposes, the actual market value of the quarters or market rent is irrelevant. Moreover, if certain accommodation costs have been incurred by Amy, such as the 2% nominal rent, it is possible for the cost to be deducted as 'rent suffered' from the 'rental value' calculated, and the net balance will be the taxable value. If the total rent suffered exceeds the rental value calculated, any 'negative' value will be reduced to zero.

(iii) The payment of the 'housing subsidy' of $20,000 to Amy would be made, subject to Amy's full discretion of use, without any restriction. This would cover the situation where Amy would still be paid the subsidy even though she does not incur any cost on her accommodation. In the circumstances, the subsidy is simply a cash allowance paid in addition to salary for Amy's services from her employment. The total amount of $20,000 per month would be assessed to salaries tax in full.

(iv) Assuming that Amy intends to lease an apartment or a hotel room, Amy should consider asking H Ltd to arrange for the housing benefit to be in the form of a 'rent refund' or 'rent reimbursement'. Under this arrangement, H Ltd will reimburse all or part of the rent (up to the maximum of $20,000 per month) paid by Amy to the landlord (or hotel). The actual rent amount so reimbursed by H Ltd would be ignored and not taxable for salaries tax, but instead, Amy will be deemed to have received a 'rent-free' residence and be taxed at 'rental value'. This tax position is similar to the staff quarters scenario (as explained in (a)(ii) above), and the amount of 'rental value' is calculated using the same formula. However, if Amy leases a hotel room instead of an apartment, 4% will be applied in the rental value formula instead of 10%. Alternatively, H Ltd may enter into the lease directly with the landlord and pay the rental directly, provided that the actual rent does not exceed $20,000 per month. The actual rent paid by H Ltd would also be ignored and the taxable value will still be based on the 'rental value' calculated. In the event that the actual rent paid exceeds the monthly limit of $20,000 reimbursed by H Ltd, the excess portion is regarded as 'rent suffered' by Amy and could be deducted from the 'rental value'. However, if the actual rent is less than the monthly limit of $20,000 reimbursed/paid by H Ltd, caution is required that the shortfall portion should not be 'paid back' to Amy as additional remuneration. If this happens, the total housing benefit would be considered as a cash allowance pursuant to the 'salary sacrifice' principle, and become fully taxable.

In most circumstances, the tax position calculated under the rent reimbursement arrangement would be more beneficial than that under the housing subsidy/allowance arrangement. Therefore, such a scheme is subject to stringent scrutiny by the IRD. For such a scheme to be accepted as valid, the employer's intention to provide the accommodation on a 'reimbursement' basis should be clearly stated in the employment contract, including the controls to be exercised by the employer to ensure that the reimbursement is genuinely spent on accommodation leasing. These controls would include the reimbursement of rental based on actual rent subject to a maximum limit; the requirement to submit the stamped lease agreement and the rental receipts to prove the genuine lease payments; the benchmarking of the lease rental to market rent to avoid excessive payment; and the retention of relevant records by the employer. If H Ltd enters into the lease directly with the landlord, the administrative procedures and burden may be simplified.

(b) Performance incentive scheme

(i) (1) The tax position under share option schemes is different from that under share awards. If Amy is granted an option to acquire the shares in either H Ltd or M Ltd, the benefit from the option would be taxable at the time when the option is exercised, assigned or released [s.9(1)(d)]. Hence, the benefit would be excluded from the calculation of rental value. For this purpose, it is irrelevant as to whether the share option relates to shares in H Ltd or M Ltd for the reason that both companies are associated. Moreover, the facts that shares in both companies are not listed in Hong Kong, and that M Ltd is a non-Hong Kong company would not affect the taxability of the deemed gain arising from the share option.

Despite the share option having a vesting period of two years, the source of the share option is determined on the basis of Amy's tax position at the time when the option is granted. Since Amy is working for H Ltd which is a Hong Kong resident employer company, Amy is regarded as holding a Hong Kong employment at the time of being granted the option. Therefore, Amy will be taxable anytime when she exercises, assigns or releases the option. During the vesting period, there is no tax liability arising to Amy. Upon becoming fully vested, when the option is exercised, the taxable value equals to the total value of the shares making reference to the share market price at the time of exercise, deducting the total cost incurred on the option as well as on exercising the option to acquire the shares. The fact that the shares have not yet been sold at the time of exercise is irrelevant. Moreover, when the shares are subsequently sold at a gain, the gain would not be taxable under salaries tax as it is regarded as a return from personal investment. Where the option is not exercised but assigned or released, the taxable value is calculated by reference to the total consideration/compensation received after deducting the related cost on the option.

Upon expiry of the employment contract, if Amy chooses to return to Malaysia permanently with the share option un-exercised, she may elect to be deemed to have 'notionally' exercised the share option before leaving Hong Kong, and to be assessed on the deemed gain in her final Hong Kong tax assessment. The deemed taxable value will be calculated by reference to the share price on a day within seven days before the day when her final Hong Kong tax return is filed by Amy, or when the election is made within three months from the date Amy left Hong Kong, by reference to the share price on the date of leaving Hong Kong. Upon paying the finalised tax on the notional exercise of the share option before leaving Hong Kong, Amy is no longer required to report to the IRD when she subsequently exercises the share option overseas. No further Hong Kong tax will be imposed even if there is an increase in the share market price at the time of subsequent exercise. However, in the case where the share market price is lower than that used for tax assessment before leaving Hong Kong, Amy may submit an application to the IRD to have her tax assessment revised and the excess tax paid refunded.

(2) If Amy chooses to receive the shares instead of the option, she will be taxed on the total market value of the shares as a perquisite at the time she is entitled to the ownership of the shares after the shares are fully vested (the 'back-end approach') [s.9(1)(a)]. Hence, any gain will be included in the calculation of rental value. The taxable value will be determined by making reference to the share market value at the time when the shares are fully vested. During the vesting period, no tax liability will arise to Amy. If a dividend is distributed during the vesting period, Amy will not be taxed. However, at the time when the shares are fully vested and Amy receives a lump sum payment equivalent to the amount of dividend distributed during the vesting period, the lump sum payment will then become taxable income from the employment.

(ii) In the event that Amy chooses to exercise the share option after she returns to Malaysia following the expiry of her employment contract, and she has not elected to 'notionally' exercise before leaving Hong Kong, the deemed gain arising from the subsequent exercise needs to be reported to the IRD and be subject to salaries tax in Hong Kong. The fact that, at the time of exercising the option, Amy is no longer in Hong Kong or with a Hong Kong employment is irrelevant. The timing of assessing the deemed gain from the share option would depend on the timing of exercising the option. For this purpose, s.11D(b)(ii) which deems any post-cessation receipts from employment to accrue on the last day of employment does not apply. When Amy is assessed on the deemed share option gain, it is possible that she would be entitled to a full year's personal allowance to offset against the deemed gain in that year. This may give rise to a lower level of tax liability. Therefore, it is possibly more advantageous for Amy to exercise the share option after returning to Malaysia.

As regards the share awards, since the time of assessment is the time when Amy is entitled to the ownership of the shares, i.e. at the time when the shares are fully vested with her, it is likely that she would be fully taxed on the share value in Hong Kong before she leaves. So Amy choosing to sell the shares after she returns to Malaysia would not be relevant.

(c) Tax equalisation compensation

Section 9(1)(a) of the IRO seeks to define income from employment to include 'any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite or allowance'. A perquisite or benefit will be subject to salaries tax if the benefit represents a discharge by the employer of the employee's liability, or if the benefit is convertible into cash. The tax liability is imposed on Amy in respect of her income from employment sourced in Hong Kong. If H Ltd seeks to reimburse or compensate all or part of the tax payment, it represents a discharge, in whole or in part, by H Ltd of Amy's personal liability and the reimbursement or compensation is taxable. Moreover, if the tax compensation is specified in the employment contract forming part of the remuneration package which seeks to induce Amy to sign the contract, the whole amount of any compensation would be taxable. This would be the case even though part of the compensation may arguably be attributable to Malaysian tax.

3 Roger

(a) (i) HK tax and stamp duty implications if the property is acquired in his personal name

The first point to note is that if Roger acquires the property in his personal name, the rental income will be chargeable to property tax rather than profits tax. Under s.5(1) of the Inland Revenue Ordinance ('IRO'), property tax is levied on any owner of land or buildings or land and buildings situated in Hong Kong, at the standard rate (15%) on the net assessable value of the property.

'Net assessable value' as defined under s.5B includes any consideration payable in money or money's worth in respect of the right to use the land and/or buildings, as reduced by two types of deductions:

(1) government rates paid by the owner if it has been so agreed between the owner and the tenant; and

(2) a statutory allowance of 20% of the assessable value after deducting rates if applicable.

The statutory allowance is deemed to cover all related expenses incurred by the owner on the property. Therefore, all other actual expenses incurred by Roger, including the management fee, rates and interest, will not be deductible for property tax purposes.

Property tax can work unfairly where a person incurs expenses greater than the deemed 20% allowance. There would be particular hardship if interest deductions could not be taken into account. The IRO gives relief by providing that, if Roger elects for personal assessment, he will be entitled to a deduction for interest incurred by him to acquire the property [s.42(1)].

Because this is not a profits tax case, the limitations on deductibility of interest as set out in s.16(2) do not apply. Roger is therefore entitled to deduct the interest paid to the company carrying on business in China, even though the company is not subject to Hong Kong tax on the interest it receives. However, the deduction is limited to the 'net assessable value' of the property, i.e. 80% of the total rental received.

The final point to consider is stamp duty. Conveyances on the sale or transfer of immovable property in Hong Kong are subject to stamp duty under Head 1 of the Stamp Duty Ordinance ('SDO'). The chargeable document is the agreement for sale and purchase, and it is liable to *ad valorem* duty at rates ranging from $100 (for a value not exceeding $2,000,000) to 4·25% (for a value exceeding $20,000,000).

The dutiable value is usually based on the transaction price or consideration, unless the consideration is below the market price, in which case the property market value would be used for stamping purposes. Therefore, the stamp duty payable is 4·25% on $30 million, i.e. $1,275,000. Where the sale and purchase agreement is stamped, the subsequent formal assignment or conveyance executed in conformity with the stamped agreement will be liable to a fixed duty of $100. The law stipulates that both parties to the transaction are jointly and severally liable to pay the stamp duty, but in market practice, the purchaser is normally the person to pay.

In addition, special stamp duty ('SSD') will be payable if the residential property was acquired by the seller on or after 20 November 2010 and is resold by that seller within 24 months. The applicable rates of SSD depend on the holding period, the longer the holding period the lower the rate of duty. If the property was acquired by the seller prior to 20 November 2010, no SSD is payable.

SSD is applicable even if the seller is an incorporated company, and is jointly and severally payable by both the purchaser (Roger) and the seller (Landlord Ltd). In Roger's case, it is unclear when the property was acquired by Landlord Ltd. Roger is therefore advised to obtain more information from Landlord Ltd, in order to ascertain whether the property will fall within the SSD regime. If so, he may seek to negotiate and agree with Landlord Ltd as to which party will pay and bear the duty, and to have this specified in the agreement.

(ii) HK tax and stamp duty implications if all the shares in Landlord Ltd together with the shareholder's loan are acquired

The first point to note is that if Roger acquires all the shares in Landlord Ltd, the rental income will be chargeable to both property tax and profits tax. Section 5(1) is still applicable on the basis that Landlord Ltd will still be considered as the 'owner' of the property. Any rental income so received is subject to property tax calculated in the same manner as for an individual (as above).

However, according to s.2, 'business' is defined to include the letting or sub-letting of property by a corporation. Moreover, under s.14, any person who carries on a trade, profession or business in Hong Kong and derives assessable profits in Hong Kong will be subject to profits tax. Landlord Ltd is regarded as carrying on the business of property letting in Hong Kong and will be subject to profits tax.

This double taxation of Landlord Ltd can be eliminated by the application of s.5(2)(a). Under this section, any corporation which is subject to profits tax in respect of rental income can apply for an exemption from property tax in relation to the same rental income so that the rental income is only subject to profits tax. Alternatively, Landlord Ltd can rely on s.25 to claim the set off of the property tax paid against the profits tax payable.

Profits tax under s.14 is imposed on the assessable profits which take into account all relevant expenses and outgoings which are incurred in the production of assessable profits [s.16(1)]. Landlord Ltd is therefore able to deduct the related expenses such as management fees and rates. In addition, commercial building allowance will be calculated and deductible against the rental income. However, Landlord Ltd will not be entitled to a deduction for the interest paid to the company carrying on business in China, because such interest amount is not subject to Hong Kong tax in the hands of the lender [s.16(2)(c)]. In a situation where total deductible expenditure exceeds total income, the excess loss can be carried forward to subsequent years and is eligible for deduction against any future assessable profits. Currently, the profits tax rate applicable is 16·5%.

The final point to consider is stamp duty. The shares of Landlord Ltd, which is a Hong Kong company, are Hong Kong stock: definition in s.2(1) of the SDO. Therefore the parties effecting the sale and purchase thereof must prepare and stamp contract notes for the sale and purchase and an instrument of transfer [s.19(1) and Heads 2(1) and 2(4) respectively]. Duty on the contract notes under Head 2(1) is 0·2% of the amount or value of the consideration; duty under Head 2(4) on the instrument of transfer is $5.

Because the transfer of Hong Kong stock is subject to the payment of further money for the assignment of the shareholder's loan, this additional money is also considered to form part of the total amount on which stamp duty is to be assessed [s.24(1)]. Therefore, stamp duty on the contract notes under Head 2(1) is $60,000 ($30m x 0·2%). Because the seller and the purchaser are each liable to pay one-half of this amount, it follows that the amount payable by Roger is $30,000, which is much lower than the amount payable ($1,275,000) if the property, not the shares, were acquired by Roger.

The final issue relates to the consequences of having prepared two separate documents in respect of the same transaction. The SDO stipulates that all the facts and circumstances affecting the liability of any instrument to stamp duty must be fully and truly set forth in the instrument [s.11]. This means that the share transfer document should contain a reference to the related assignment of the shareholder's loan, because this would affect the calculation of stamp duty payable. Furthermore, the party preparing the documents would have committed an offence, if, having been employed or concerned in or about the preparation of the instrument, the party has neglected or omitted fully and truly to set forth in that instrument all the relevant facts and circumstances. However, the offence is only committed if the party did so with an intent to defraud the Government, and not simply out of inadvertence of the SD consequences.

(b) Section 60(1) of the IRO empowers the assessor to raise any assessment within six years after the end of the year of assessment in which a transaction or event occurs. In the case of fraud or wilful evasion, the six-year time limit prescribed for raising an assessment is extended to ten years. The power also extends to additional assessments, within the aforesaid time limits, as applicable, in respect of any year of assessment for which an assessment has already been issued, if the assessor is of the opinion that the taxpayer has been under-assessed for that year of assessment.

In the case of Landlord Ltd, the understatement of rental income relates to the year of assessment 2008/09; and any additional assessment can be issued within six years after the end of the year assessment 2008/09, i.e. on or before 31 March 2015. Therefore, Roger should ask for an indemnity from Richard to shelter any additional tax liabilities which may arise as a result of additional assessments being raised by the assessor within the time limit of six years, or ten years in the case of fraud or wilful evasion. Normally, if the due diligence gives a satisfactory result, the time frame for such an indemnity should be long enough to cover the six-year time limit. If the due diligence reveals any possibility of fraud or wilful evasion, the tax indemnity is normally asked to cover at least ten years.

4 Mr Ma

(a) Whether the penalty tax assessments can be challenged

For an objection to be valid under s.64(1), it must:

(i) be in writing and addressed to the Commissioner;
(ii) state precisely the grounds for the objection;
(iii) be received by the Commissioner within one month after the date of the notice of assessment; and
(iv) be accompanied by a proper tax return, including a nil return, if the assessment was an estimated assessment under s.59(3) of the IRO.

In this case, requirements (iii) may pose a problem because the one-month period has already expired. *Prima facie* the objection cannot be made. However, s.64(1) proviso (a) requires the Commissioner to accept the objection after the one-month period if he is satisfied that the taxpayer is prevented from making the objection within such period due to absence from Hong Kong or other reasonable cause. This would be relevant to Mr Ma as he was in France when the assessments were issued to him.

However, even if a late objection could have been lodged because Mr Ma was absent from Hong Kong when the assessments were issued, the fact remains that no objection was subsequently lodged upon Mr Ma's return. In the circumstances, the estimated assessments are clearly now final and conclusive for all purposes of the IRO [s.70]. Mr Ma has therefore lost his right of objection.

(b) Meaning of 'reasonable excuse'

A person is not liable to be assessed under s.82A if he has a 'reasonable excuse' in committing the wrongdoing in respect of which the tax under s.82A is charged on him.

There is no statutory definition of this term, and what constitutes a 'reasonable excuse' must of course depend upon the circumstances of each case. In *D13/85*, the Board of Review described the concept of 'reasonable excuse' as follows:

'We consider that the correct test to be applied in ascertaining 'reasonable excuse' is what one would expect a reasonable person to do in all of the circumstances. A reasonable person is not a perfect person, but an average person using the reasonable skill and care in handling his taxation affairs which one would expect to see from such an average person.'

Therefore, a person would have to show that he acted reasonably and in good faith in doing what he did, and that a reasonable person would regard this as an excuse consistent with a reasonable standard of conduct.

To illustrate this proposition, reference is made below to various decisions of the Board of Review.

In *BR80/76* an individual was held to have a reasonable excuse by having an honest and reasonable belief that the transactions entered into were not trading transactions subject to profits tax and have relied upon professional advice that the income was not taxable, even though it subsequently proved to be taxable.

However, mere reliance on professional advice may not prevent the application of s.82A where that reliance is unreasonable in the circumstances. In *D1/82* the Board said, *'Indeed we would comment that, as a general rule, unless an issue arises as to the taxability of any transaction, a taxpayer does not absolve himself from the penal consequences of the Ordinance simply because he had left his tax affairs in the hands of a qualified person if the returns submitted by him show an understatement of profits. He is answerable for those employed by him in the absence of some reasonable excuse.'*

In *D2/81*, the taxpayer was held to have a reasonable excuse where the taxpayer had no income or losses for the year in which the penalty tax assessment was raised.

However, it was held in *BR7/79* that it was not a reasonable excuse for understating income in a salaries tax return to say that the amount in question was correctly reported in the employer's return and that therefore the Commissioner had the true information in his possession anyway.

(c) Whether the penalty tax assessments can be challenged

Any appeal against the penalty tax assessments raised must be made in writing within one month of the receipt of the assessments, that is on or before 3 January 2015. Section 82B(1)(a) of the IRO provides for an extension of the time limit in circumstances prescribed in s.82B(1A).

The appeal notice must include the following documents:

(1) a copy of each notice of assessment to penalty tax;
(2) a statement of the grounds of appeal; and
(3) a copy of the notice issued by the Commissioner under s.82A(4) of the IRO.

Turning now to possible avenues for challenging the penalty tax assessments, it should be noted that failure to file tax returns by the due date is an offence for which the Commissioner is entitled to raise additional (or penalty) tax under s.82A. Under this section, the Commissioner can impose penalty tax up to a maximum of three times the tax which would have been undercharged. The Commissioner or Deputy Commissioner must make the assessment personally. In Mr Ma's case, all these formal requirements have been met.

However, before any valid assessment is made under s.82A, a formal notice of intent to assess must have been sent to Mr Ma by the Commissioner or Deputy Commissioner personally. In accordance with s.82A(4) the notice must:

(1) specify the offence in respect of which the additional tax is to be assessed;
(2) inform Mr Ma of his right to submit written representations; and
(3) specify a date by which the representations must be received.

If, as Mr Ma has advised, no such notice of intent has been sent to him by the Commissioner or Deputy Commissioner, the assessments would not have been validly raised. This is the first possible avenue for challenging the penalty tax assessments, but it would be prudent to check with the IRD first to see whether any notice was sent to Mr Ma.

Assuming that a notice was sent to Mr Ma prior to the issue of the penalty tax assessments, Mr Ma may appeal to the Board of Review on the following grounds:

(1) that he has a reasonable excuse for failure to lodge timely returns and he is not therefore liable to penalty tax; and
(2) that although the penalty tax is validly imposed, it is excessive having regard to all the circumstances.

Turning to each of these grounds:

Reasonable excuse

The problem of staff replacement for his accountant cannot be regarded as a reasonable excuse. As discussed in (b) above, to constitute a reasonable excuse Mr Ma would have to show that he has exercised the skill and care in handling his taxation affairs which one would expect to see from an average person: see *D13/85*. It would be difficult to convince the Board of Review that a reasonable excuse was present in his case.

Penalty excessive in all the circumstances

When considering this aspect of any appeal, the Board of Review makes an independent judgement whether the penalty tax is reasonable and not clearly excessive in the circumstances. In this regard, it is noted that the penalties, of 50% and 100% respectively, appear to be quite harsh. Although the amount of the additional tax is at the discretion of the Commissioner, the IRD has published guidelines as to how this discretion is exercised and these can be found on their website. In the case of the late filing of profits tax returns, if the relevant return is filed after two or more estimated assessments have been issued, the general level of additional tax is respectively 20%, 30% or 50% for a first, second or third and subsequent offence within five years. It is therefore concluded that a good argument could be put to the Board of Review that the penalty tax raised in Mr Ma's case is excessive.

5 Success Ltd

(a) **Ascertainment of the basis period on a change of accounting date**

When a taxpayer's accounts are not made up to the corresponding day in the following year of assessment or to more than one day in the following year of assessment, the Commissioner is empowered to compute the assessable profits for the year of change, and to recompute the assessable profits for the preceding year, on a basis that the Commissioner thinks appropriate [s.18E(1)].

In ascertaining the basis period for the year of change and the year preceding the year of change, the general principles to be followed are:

(1) to adopt the new accounting date as soon as possible;

(2) to ensure that

- for a new business (commencing on or after 1 April 1974), none of the profits arising during the life of the business falls out of the profits tax net; and
- for an old business (commencing before 1 April 1974), the period left out of assessment is not one of high profit.

(3) to amend the basis period for the preceding year to the new accounting date only if this gives a larger profit; and

(4) to ensure fairness to both the IRD and the taxpayer.

(b) **Assessable profits for the affected years of assessment**

When Success Ltd changed its accounting date from 31 December to 31 March, the year of change is 2013/14 on the basis that it fails to make up accounts based on the corresponding day in the year, i.e. it fails to make up accounts to 31 December 2013 for 2013/14. The year preceding the year of change is 2012/13. The year 2013/14 is the first assessment year which adopts accounts made up to the new accounting date.

The Commissioner will usually take the new accounting year end date, i.e. 31 March 2014, as the end date of the basis period for the year of change 2013/14. As Success Ltd commenced business in 1970, it is an old business. Under s.18E, for old businesses, the basis period for the year of change must be 12 months. On this basis, the basis period for the year of assessment 2013/14 will be from 1 April 2013 to 31 March 2014, and profits for the period from 1 January 2013 to 31 March 2013 will drop out of assessment.

However, if the change of accounting date was made for the sole or dominant purpose of obtaining a tax benefit through the expected drop out of profit, the tax benefit may be countered by the application of s.61A and the Commissioner is entitled to adopt a basis period of more than 12 months irrespective of s.18E: see *Yick Fung Estate Ltd* v *CIR*.

It is therefore necessary to check the reasons for which the change in accounting date is made. If the change is made primarily for genuine business purposes other than tax avoidance, s.61A does not apply and as the Commissioner is bound by the *Yick Fung* case, he can only take basis periods not exceeding 12 months for the years of assessment 2012/13 and 2013/14 even though doing so may result in the dropping out of assessable profits with respect to a three-month period. The onus of proving the existence of a primary non-tax business purpose rests with the taxpayer. From the facts given, the change of accounting date is caused by the change in the business peak season. It appears to be a genuine business reason and is likely to be acceptable to the Commissioner as a non-tax reason if sufficient supporting evidence can be produced.

Assuming the Commissioner will accept that the change of accounting date is not primarily for tax avoidance, the basis periods for the years of assessment 2012/13 and 2013/14 will each be 12 months and are likely to be:

Year of assessment		**Basis period**
2013/14		1 April 2013 to 31 March 2014
2012/13	either	1 January 2012 to 31 December 2012
	or	1 April 2012 to 31 March 2013

The Commissioner will likely take the basis period for 2012/13 which will produce the bigger amount of assessable profits. The amount of assessable profits for the three months which would not be included in any basis period, i.e. either the three months to 31 March 2013 or the three months to 31 March 2012 will never be assessed.

Year of assessment 2013/14

Basis period: 1 April 2013 to 31 March 2014	
Adjusted profits before depreciation allowance (2·4m * 12/15)	$1,920,000

Year of assessment 2012/13

Original assessment

Basis period: 1 January 2012 to 31 December 2012	
Adjusted profits before depreciation allowance	$1,700,000

Revised assessment (with new accounting date)

Basis period: 1 April 2012 to 31 March 2013	
Adjusted profits before depreciation allowance (1·7m * 9/12 + 2·4m * 3/15)	$1,755,000

As the revised assessment gives rise to higher adjusted profits, the revised basis period from 1 April 2012 to 31 March 2013 will be adopted, and the three months to 31 March 2012 will not be assessed.

Although the basis period from 1 January to 31 March 2012 will not be assessed, capital expenditure incurred in this interval between the basis periods for 2011/12 and 2012/13 is deemed to be incurred in the basis period of the later year of assessment 2012/13 [s.40(1)]. Therefore, depreciation allowance in respect of the asset acquired on 10 January 2012 can be claimed in 2012/13.

The depreciation allowance schedules for the years of assessment 2012/13 and 2013/14 will be computed as follows:

Depreciation allowance schedule

	20% $	30% $	Total $
Year of assessment 2012/13			
Written down value (WDV) brought forward	88,000	161,000	
Additions	30,000	40,000	
Initial allowance (IA) at 60%	(18,000)	(24,000)	42,000
	100,000	177,000	
Annual allowance (AA)	(20,000)	(53,100)	73,100
			115,100
Year of assessment 2013/14			
WDV brought forward	80,000	123,900	
Additions		20,000	
IA at 60%		(12,000)	12,000
		131,900	
AA	(16,000)	(39,570)	55,570
WDV carried forward	64,000	92,330	67,570

The assessable profits for the years of assessment 2012/13 and 2013/14 are therefore:

Profits tax computation

	2012/13 $	2013/14 $
Adjusted profits	1,755,000	1,920,000
Less: Depreciation allowance	(115,100)	(67,570)
Assessable profits	1,639,900	1,852,430

(c) Effect if change of date is not for a genuine business reason

The change of the accounting date from 31 December to 31 March would lead to the exclusion of three months' profits from the year of assessment 2013/14 and therefore make them not subject to profits tax. Since in this case, the change in the accounting date is not for *bona fide* commercial reasons but for the sole or dominant purpose of avoiding tax, the Commissioner will likely seek to apply s.61A and adopt a basis period of 15 months for the year of assessment 2013/14 to counteract the tax benefit. The basis periods for the years of assessment 2012/13 and 2013/14 will likely be:

Year of assessment	**Basis period**
2013/14	1 January 2013 to 31 March 2014
2012/13	1 January 2012 to 31 December 2012

As there is no drop-out period in the year of change, the Commissioner usually will not revise the assessment for the year preceding the year of change.

Because there is no drop-out period, the basis periods for the two years of assessment are contiguous. So only the depreciation allowance for the asset acquired on 10 January 2012 will be claimed for the year of assessment 2012/13 and the allowance in respect of the assets acquired on both 15 January 2013 and 1 February 2014 will be claimed for the year of assessment 2013/14.

				Available	*Maximum*
1	**(a)**	**(i)**	**Low interest rate loan – implication to Kam Kee**		
			Interest income is deemed trading receipt (s.15)	0·5	
			In respect of business fund	0·5	
			Hong Kong sourced	0·5	
			Provision of credit test	0·5	
			Except mortgage loan or money-lending business	0·5	
			Place where the credit is first made available to borrower	0·5	
			Staff loan is for buying HK properties thus presumably HK-sourced	0·5	
			Interest income taxable to Kam Kee	0·5	
			Write-off is not incurred in production of assessable profits	0·5	
			Write-off not deductible	0·5	5
		(ii)	**Low interest rate loan – implication to employees**		
			If used as primary place of residence	0·5	
			Home loan interest is deductible	0·5	
			$100,000 per annum	0·5	
			Maximum 15 years, not necessarily consecutive	0·5	
			Interest rate differential is not taxable to employees	0·5	
			Sole liability of the employer	0·5	
			Not convertible into cash by employees	0·5	
			Salaries tax positions not relevant to Kam Kee	0·5	4
	(b)	**(i)**	**Medical subsidy to staff**		
			General deduction rule under s.16(1)	1·0	
			Employees' benefit or perquisite, hence deductible	0·5	
			Reimbursement of non-deductible expense taxable to employees	0·5	
			Deductibility not affected by employees' tax treatment	0·5	
				2·5	2
			Medical insurance premium deductible to Kam Kee (s.16(1))	0·5	
			No difference from current position	0·5	
			But employees' salaries tax positions are different	0·5	
			Insurance reimbursement not taxable	0·5	
			Not convertible into cash	0·5	
			Paid in the capacity of beneficiaries	0·5	
			Profits tax deductibility not affected	0·5	
				3·5	3
		(ii)	**Compensation to staff on leaving**		
			If capital expenditure, not deductible (s.17(1)(c))	0·5	
			Fixed vs circulating capital test	1·0	
			Once-and-for-all test	1·0	
			Enduring benefit test	1·0	
			Conclusion: restrictive covenant is enduring, so not deductible	0·5	4
		(iii)	**Interest expense on bank mortgage loan**		
			Incurred in the production of assessable profits (s.16(1))	0·5	
			Money borrowed for producing assessable profits (s.16(2)(a))	0·5	
			How the loan proceeds are applied	0·5	
			Staff quarters is an employee benefit	0·5	
			Irrelevant that the property is a capital asset	0·5	
			Mortgaged over the property; s.16(2A) does not apply	0·5	
			No flow back; s.16(2B) does not apply	0·5	
			Conclusion: interest is deductible	0·5	4

		Available	Maximum
(c)	**Computation of profits tax liability**		
	Compensation for cancellation of contract not adjusted	0·5	
	Sponsor to staff on courses not adjusted	0·5	
	Staff quarters expenses not adjusted	0·5	
	Replacing old carpets not adjusted	0·5	
	Legal and professional fee on tax appeal added back	0·5	
	Tax penalty added back	0·5	
	Refurbishment 80% added back (or 100% added back and 20% deducted)	0·5	
	Crockery and cutlery not adjusted	0·5	
	Depreciation allowance calculated and deducted	1·5	
	Interest income from Mr Kam deducted	0·5	
	Tax loss brought forward deducted	0·5	
		6·5	6
(d)	**HK tax implications on acquiring a new restaurant**		
	Trading stock as cost of goods sold and tax deductible	0·5	
	Higher allocated value more advantageous	0·5	
	Reasonable and benchmarked to market	0·5	
	Furniture and fixtures for tax depreciation allowance	0·5	
	Higher allocated value more advantageous	0·5	
	Goodwill is capital and not deductible	0·5	3
Appropriate format and presentation		1·0	
Logical development		1·0	
Effectiveness of communication		2·0	4
			35

				Available	Maximum
2	(a)	(i)	**Employment with M Ltd or H Ltd**		
			Accommodation a specified taxable benefit	0·5	
			Provided by either employer or associated corporation	0·5	
			Conclusion: irrelevant who is the employer	0·5	
				1·5	1
		(ii)	**Amy's position if living in staff quarters**		
			Rental value	0·5	
			10% of assessable income (excluding share option, retirement, terminal payment) after deducting expenses and depreciation	1·0	
			Actual market value or rent is irrelevant	0·5	
			Rent suffered is deducted from rental value	0·5	
			2% nominal rent and property management fee are rent suffered	0·5	
			If negative, reduced to zero	0·5	
				3·5	3
		(iii)	**Amy's position if receiving a housing subsidy**		
			If regardless of usage or without restriction	0·5	
			Cash allowance, taxable in full	0·5	1
		(iv)	**Tax efficient scheme for Amy renting accommodation**		
			Rent refund	0·5	
			Rental value taxed	0·5	
			Actual rent reimbursed is ignored	0·5	
			10% for apartment	0·5	
			4% for one hotel room	0·5	
			Alternatively, H Ltd to enter into a lease directly with the landlord	0·5	
			If excess paid, rent suffered deducted	0·5	
			Not salary sacrifice	0·5	
			Rent reimbursement more beneficial than subsidy	0·5	
			Stated in the employment contract	0·5	
			Control by the employer to ensure genuinely incurred	0·5	
			Submit lease agreement and proof of rental payment	0·5	6
	(b)	(i)	**(1) Taxability of share option**		
			Taxable upon exercise, assignment and release	0·5	
			Excluded from the calculation of rental value	0·5	
			Irrelevant whether shares relate to H Ltd or M Ltd	0·5	
			Source of share option depends on timing of option granted	0·5	
			No tax liability during vesting period	0·5	
			Share market price at time of exercise	0·5	
			Minus total cost of option and exercising the option	0·5	
			Subsequent sale of shares is irrelevant	0·5	
			For assignment or release, consideration minus costs	0·5	
			Before leaving HK, elect to notionally exercise	0·5	
			Determination of deemed taxable value	1·0	
			No further tax upon subsequent exercise in Malaysia	0·5	
			If share price is lower, excess tax paid refunded	0·5	
				7	6
			(2) Taxability of share awards		
			Share market value taxable	0·5	
			At the time when entitled to ownership of shares	0·5	
			At end of vesting period (back-end approach)	0·5	
			Gain included in the calculation of rental value	0·5	
			No tax liability during vesting period	0·5	
			Dividend is not taxable if received during vesting period	0·5	
			Lump sum dividend payment received upon fully vested is taxable	0·5	
				3·5	3

		Available	*Maximum*
(ii)	**Whether more advantageous to exercise/sell when back in Malaysia**		
	Deemed gain from option exercise is taxable for salaries tax	0·5	
	Full year's personal allowance to offset	0·5	
	Lower tax liability likely	0·5	
	More advantageous when exercised in Malaysia	0·5	
	Share awards are taxed when vested	0·5	
	Irrelevant for share awards when sold	0·5	3

		Available	*Maximum*
(c)	**Tax equalisation compensation**		
	Perquisite	0·5	
	Discharge by employer of employee's liability	0·5	
	Convertible into cash	0·5	
	Tax borne is taxable	0·5	
	Including the portion re Malaysian tax if specified in the contract	0·5	
		2·5	2
			25

				Available	Maximum
3	(a)	(i)	**Tax implications if property is acquired**		
			Rental income subject to property tax under s.5(1)	0·5	
			On owner at standard rate on NAV	0·5	
			Definition of NAV	0·5	
			Actual expenses not deductible	0·5	
			Interest not deductible unless personal assessment is elected	1·0	
			Not necessary that lender is subject to tax	0·5	
			But interest limited to NAV	0·5	
			Conveyance on sale subject to stamp duty	0·5	
			Agreement for sale liable to *ad valorem* duty	0·5	
			Stamp duty payable is $1,275,000	0·5	
			Formal assignment liable to a fixed duty of $100	0·5	
			Both parties liable	0·5	
			SSD payable if property acquired by seller on or after 20 November 2010	0·5	
			Even if seller is an incorporated company	0·5	
			Seller and buyer jointly and severally liable	0·5	
			Check with seller whether SSD is payable	0·5	
			Agree with seller who will bear the SSD	0·5	
				9	8
		(ii)	**Tax implications if shares are acquired**		
			Rental income subject to both property tax and profits tax	0·5	
			Property tax calculated in the same way as an individual	0·5	
			Business includes letting or sub-letting by a corporation	0·5	
			Landlord Ltd is carrying on a business of property letting	0·5	
			Exempt from property tax under s.5(2)(a)	0·5	
			Or property tax set off against profits tax under s.25	0·5	
			Revenue expenses and commercial building allowance deductible	0·5	
			Interest not deductible under s.16(2)(c)	0·5	
			Loss carried forward under profits tax	0·5	
			Shares in Landlord Ltd are Hong Kong stock	0·5	
			Prepare and stamp contracts notes and instrument of transfer	1·0	
			Stamp duty also payable on the transfer of shareholder's loan	1·0	
			Stamp duty payable is $60,000	0·5	
			$30,000 payable by Roger much lower than $1,275,000	0·5	
			Requirement for all facts to be in the instrument of transfer	1·0	
			Potential consequences of having two separate documents	1·0	
				10	9
	(b)	**Tax implications of discovered error**			
		Additional assessment within six years under s.60(1)		0·5	
		Extended to 10 years in the case of fraud or wilful evasion		0·5	
		Additional assessment for 2008/09 on or before 31 March 2015		1·0	
		Ask for tax indemnity		1·0	3
					20

			Available	Maximum
4	(a)	**Whether objection can be lodged against the estimated assessments**		
		Objection in writing	0·5	
		With grounds	0·5	
		Within one month	0·5	
		Accompanied by a tax return	0·5	
		Late objection if prevented due to absence from HK	1·0	
		But objection not lodged upon return	0·5	
		No right of objection	0·5	4
	(b)	**Meaning of 'reasonable excuse'**		
		Not liable to penalty tax if he has a 'reasonable excuse'	0·5	
		No statutory definition of 'reasonable excuse'	0·5	
		Depend upon the circumstances of each case	0·5	
		Concept of 'reasonable excuse' in *D13/85*	1·0	
		Acted reasonably and in good faith	1·0	
		Examples of 'reasonable excuse'		
		– Honest and reasonable belief not subject to tax	0·5	
		– Reasonable reliance on professional advice	1·0	
		– No income or loss	0·5	
		Income reported by employer not a reasonable excuse	0·5	
			6	5
	(c)	**Whether the penalty tax assessments can be challenged**		
		Appeal in writing within one month	1·0	
		Documents required	1·5	
		Failure to file tax returns an offence to which s.82A is applicable	0·5	
		Penalty not exceeding three times the tax undercharged	0·5	
		Penalty tax assessment made by CIR or DCIR	0·5	
		Formal notice of intent to assess must be sent to Mr Ma	0·5	
		Specifying the offence	0·5	
		Informing Mr Ma of his right to submit written representations	0·5	
		Specifying a date by which representations must be received	0·5	
		Otherwise, assessments not validly issued	0·5	
		Check with the IRD if any notice was sent	0·5	
		Grounds of appeal		
		– Has a reasonable excuse	1·0	
		– Penalty tax excessive	1·0	
		No reasonable excuse	1·5	
		Penalty tax likely to be excessive	1·5	
			12	11
				20

			Available	Maximum
5	(a)	**Ascertainment of the basis period**		
		Definition of change of accounting date	1·0	
		Principles		
		– Adopt the new accounting date as soon as possible	0·5	
		– New business: no profits falling out	0·5	
		– Old business: profit left out is not high	0·5	
		– Amend the preceding year if a larger profit	0·5	
		– Ensure fairness	0·5	
			3·5	3
	(b)	**Assessable profits of the affected years**		
		Identify the year of change and preceding year – 2013/14 and 2012/13	1·0	
		An old business	0·5	
		Basis period must be 12 months	0·5	
		Profits from 1 January 2013 to 31 March 2013 drop out	0·5	
		Basis period can exceed 12 months if s.61A applies	1·5	
		For genuine business purposes so s.61A does not apply	1·0	
		Basis period for year of change	0·5	
		Basis period for preceding year	1·0	
		Adjusted profits before depreciation	1·5	
		Basis for determining the drop-out period	0·5	
		Preceding year revised as it gives rise to a larger profit	0·5	
		Basis period for depreciation allowance	1·0	
		Depreciation allowance schedule	3·0	
		Profits tax computation	1·0	
			14	12
	(c)	**Effect if change is not for a genuine business reason**		
		Change for the sole or dominant purpose of avoiding tax	1·0	
		CIR likely to adopt a basis period of 15 months when s.61A applies	1·0	
		Basis period for year of change	0·5	
		Basis period for preceding year	1·0	
		Preceding year not likely to be revised	0·5	
		Effect on depreciation allowances	1·0	5
				20